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January 27, 2004

Ms. Jean Lange
Senior Financial Sector Advisor
Office of Economic Growth Bureau for Europe and Eurasia
USAID, Ronald Reagan Building - Room 5.08
Washington, D.C. 20523

RE: Contract No. LAG-I-00-99-00036-00
UI Project 06967-013, Southeast Europe Mortgage Fund Feasibility Study
Quarterly Task Order Progress and Cost Report, October to December 2003

Dear Ms. Lange:

Please find enclosed the *Quarterly Task Order Progress and Cost Report, October to December 2003*, Southeast Europe Mortgage Fund Feasibility Study as required under Section F.12 of the above referenced contract.

Please direct any technical questions to Ms. Sally Merrill, UI/Washington at 202.261.5755 or Email smerrill@ui.urban.org. Questions of a contractual nature should be addressed to me at (202) 261-5818.

Sincerely,

Marcus L. Stevenson

Enclosures

cc: Dale Gredler (USAID/Washington)
Sally Merrill (UI/Washington)
USAID Development Clearinghouse
IAC Deliverables File (06967-012)

**QUARTERLY TASK ORDER
PROGRESS AND COST
REPORT**

OCTOBER TO DECEMBER 2003

**SOUTHEAST EUROPE
MORTGAGE FUND FEASIBILITY
STUDY**

Prepared for



Southeast Europe Mortgage Fund Feasibility Study
United States Agency for International Development
Contract No. LAG-I-00-99-00036-00



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Prepared by

Paul Sacks.
Multinational Strategies
(Subcontractor to The Urban
Institute)

January 2004
UI Project 06967-013

QUARTERLY TASK ORDER PROGRESS AND COST REPORT

OCTOBER TO DECEMBER 2003

SOUTHEAST EUROPE MORTGAGE FUND FEASIBILITY STUDY

Task Order No.: LAG-1-00-99-00036-00

Date of Issuance: September 29, 2003

Amount Obligated Under Task Order: \$ 249,842

Total Potential Task Order Amount: \$ 249,842

Dollars Expended To-date: \$ 104,774

Key Personnel: Prime Contractor Contact: Sally Merrill, smerrill@ui.urban.org
Subcontractor Contact: Paul Sacks, pmsacks@mnsadvisors.com

Task Order Description:

The purpose of this task order is to conduct a study to determine the feasibility of establishing a private Southeast Europe (SEE) Mortgage Fund which would acquire mortgage bonds or pools of mortgages from banks or other mortgage originating institutions in SEE countries¹. The Mortgage Fund, in essence a conduit structure, would repackage these bonds or mortgage pools into securities collateralized by the underlying mortgages. The securities would be issued into the Euro-market. This would in essence provide local SEE financial institutions access to longer-term lower-cost funding from the international capital markets which is currently not available. Through its buying power, the Mortgage Fund would directly stimulate a cross-border secondary mortgage market along lines consistent with international underwriting criteria, management information systems, and documentation. The following is a list of tasks and tentative timeline for the progress of the task order.

1. Identification of possible sources of debt and equity financing for the Mortgage Fund and the main features of an offering memorandum. The team will conduct meetings in London, New York and Washington DC to determine level of interest in supplying debt and equity financing to the Conduit. (September – October 2003).
2. Assessment of funding needs of SEE banks. Interviews with local banks, analysis of bank balance sheets. (September – November 2003)
3. Detailed examination and analysis of the mortgage portfolios and processes of at least four (4) SEE banks in at least two countries in region. On site assessment of mortgage portfolios and

¹ Albania, Bosnia, Bulgaria, Croatia, Macedonia, Romania, Serbia and Montenegro, Slovenia and Kosovo

underwriting methods of at least four regional banks, analysis of bank data, follow up meetings with banks. (September 2003 – January 2004).

4. Estimation of supply and characteristics of mortgages in SEE region. Analysis of data from central banks, originating banks. (October – November, 2003).
5. Definition of Mortgage Fund concept, initial capital requirements and capital structure Modelling and analysis of data, assessment of lender, rating agency and investor input. (January – March 2004).

I. PROGRESS OF MAJOR ACTIVITIES

Workplan: Draft Workplan (November 15, 2003) and Final Workplan (November 30) following comments by the Urban Institute project reviewer. Status: Completed

Feasibility Analysis. This will involve three basic tasks: 1) canvassing major mortgage originators in Bulgaria, Croatia, and Romania, 2) determining the most appropriate sources of funding for the conduit, and the funders' preferences vis-à-vis eligibility requirements for mortgages in the pool, and 3) devising a structure suitable to all parties involved in the transactions. To date, significant progress has already been made on this activity. We have canvassed fifteen (15) of the largest mortgage originators in the three countries and called upon lending institutions in Vienna, Munich and London with a strong presumptive interest in the project. These included the parent banks of subsidiaries involved in substantial mortgage origination programs, the mortgage securitization groups of London based investment banks, as well as the EBRD and KfW. From this group we currently have at least three lending institutions, the EBRD (and potentially KfW) who have expressed strong interest in providing liquidity to the new facility. In each instance we have discussed in broad terms lender preferences as to eligible mortgages. Following our preliminary round of conversations with funders and local mortgage originators, we developed a structure intended to be responsive to principals' concerns. This structure has now been established as the basis for further discussions with the interested group of funding institutions.

Feasibility Analysis Report. Preparation of an analysis of the feasibility of establishing a Mortgage Conduit in SEE. The following assessments and analyses will be undertaken for the purposes of this feasibility report.

- Identification of possible sources of debt and equity financing for the SEE Mortgage Conduit. The team will conduct meetings in London, New York and Washington DC to determine level of interest in supplying debt and equity financing to the Conduit. (Research Completed.)
- Assessment of funding needs of SEE banks. Interviews with local banks. (Research Completed.)
- Detailed examination and analysis of the mortgage underwriting processes of at least four (4) SEE banks in at least two countries in region. On site assessment of mortgage underwriting methods of at least four regional banks, analysis of bank data, follow up meetings with banks. Status: Underway. We have selected four banks for intensive review. We conducted initial

meetings with Splitskabanka in Zagreb on December 10,11, 2003. We are now arranging follow-up meetings with Splitskabanka in Split (where many of their core functions are headquartered) hopefully for February 2-4. Our due diligence visit with Zaba Bank has been scheduled for January 28,29, 2004. Final dates for our due diligence in Bulgaria are being confirmed, but at present these will be: HVB Biochim--February 9-11, United Bulgarian Bank—February 16-17.

- Estimation of supply and characteristics of mortgages in SEE region. Analysis of data from central banks, originating banks. (Completed)
- Definition of Mortgage Fund concept, initial financial requirements and capital structure Modeling and analysis of data, assessment of lender and investor input. (December 30, 2003). Status: Definition of Fund concept, initial financial requirements and capital requirements is largely complete. Modeling and data analysis is underway
- Development of an Implementation Plan and Budget for formation of the SEE Mortgage Conduit. Status: Implementation plan completed, submitted with workplan as part of first deliverable. Draft budget prepared.

Final Report. Preparations for the final report are underway, including assessment of project feasibility, costs, and plan for implementation.

II. DELIVERABLES AND REPORTS

1. Final Workplan for the feasibility study. (November 30, 2003). Status: Delivered
2. Feasibility Analysis Report: Establishing a Mortgage Conduit in SEE. This will include an estimated budget for formation of the SEE Mortgage Conduit and a workplan for formation of the SEE Mortgage Conduit. (February 28, 2004). Status: Under Preparation.
3. Final Report (March 30, 2004). Status: To be prepared.

III. PROBLEMS OR DELAYS AFFECTING THE TASK ORDER PERFORMANCE

None at this time.

IV. SPECIFIC ACTION REQUESTED

None at this time.